No. 84-353

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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1984

In Re EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC COMPANY,
Debtor.

EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC COMPANY,
Petitioner,

vs.

THE STATE BOARD OF EQUALIZATION,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals For the Ninth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTION PRESENTED

Petitioner in this matter purchased certain tangible personal property for his use in constructing improvements to real property belonging to the United States. California law specifically provides that a sale of tangible personal property to be used for such purposes is a taxable "retail sale." Petitioner nevertheless purchased the property in question from his suppliers on a tax-free basis, certifying to them that the property was being purchased for resale. Pursuant to section 6094 of the California Revenue and Taxation Code, the State Board of Equalization subsequently assessed use taxes against petitioner measured by the purchase price of the property. The question presented is:

Did the Court of Appeals err in holding that the use taxes assessed against petitioner do not constitute direct taxes on the United States?

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RESPONDENT'S BRIEF IN OPPOSITION

Respondent respectfully requests that this Court deny the petition for writ of certiorari, seeking review of the Ninth Circuit's opinion in this case. That opinion is reported at 731 F.2d 624.

RELEVANT STATUTES AND REGULATORY PROVISIONS OMITTED FROM PETITION

This case involves a number of provisions of the California Revenue and Taxation Code which have not been included in the listing provided by petitioner. These provisions are quoted in full or in relevant part below.[1]

§ *6091. Presumption that gross receipts subject to tax: Burden of proof:*

> "For the purpose of the proper administration of this part and to prevent evasion of the sales tax it shall be presumed that all gross receipts are subject to the tax until the contrary is established. The burden of proving that a sale of tangible personal property is not a sale at retail is upon the person who makes the sale unless he takes from the purchaser a certificate to the effect that the property is purchased for resale."

§ *6094. Effect of using article bought for resale:*

> "(a) If a purchaser who gives a resale certificate makes any use of the property other than retention, demonstration, or display while holding it for sale in the regular course of business, the use shall be taxable to the purchaser under Chapter 3 (commencing with Section 6201 of this part) as of the time the property is first used by him, and . . . the sales price of the property to him shall be the measure of the tax. • • •"

§ *6094.5. Giving resale certificate for property not to be resold (as amended Stats. 1977, ch. 607):*

> "(a) Any person who gives a resale certificate for property which he knows at the time of purchase is not

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[1]All of the statutes listed are located in Deering's Annotated California Codes.

to be resold by him in the regular course of business for the purpose of evading payment to the seller of the amount of the tax applicable to the transaction is guilty of a misdemeanor.

"(b) Any person who gives a resale certificate for property which he knows at the time of purchase is not to be resold by him in the regular course of business is liable to the state for the amount of tax that would be due if he had not given such resale certificate."

§ *6201. Imposition and rates of tax:*

"An excise tax is hereby imposed on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer on or after July 1, 1935, for storage, use, or other consumption in this state * * *."

§ *6008. "Storage":*

"'Storage' includes any keeping or retention in this State for any purpose except sale in the regular course of business. . . ."

§ *6202. Persons liable for tax: Extinguishment of liability:*

"Every person storing, using, or otherwise consuming in this State tangible personal property purchased from a retailer is liable for the tax. This liability is not extinguished until the tax has been paid to this State except that a receipt from a retailer engaged in business in this State . . . given to the purchaser pursuant to Section 6203, is sufficient to relieve the purchaser from further liability for the tax to which the receipt refers."

Also involved in the case is Sales and Use Tax Regulation 1521 (18 Cal. Admin. Code § 1521), which sets forth detailed rules pertaining to the application of the sales and use tax law to both private contractors[2] and contractors

[2]The term "private contractors" as used herein refers to contractors doing business either with private parties or with the State of California and its political subdivisions.

doing business with the United States. Due to its length, the Regulation is reproduced in the accompanying Appendix.

STATEMENT OF THE CASE

Introduction

This is an action challenging provisions of the California Sales and Use Tax Law relating to construction contractors doing business with the United States—provisions which have gone unchallenged by the Federal Government itself in the nearly 50 years they have been in existence. Petitioner is Edward W.W. Howell, dba Howell Electric Co. (hereinafter "Howell"), an electrical contractor who has been operating since early 1979 under Chapter XI of the former Bankruptcy Act.[3] Respondent is the California State Board of Equalization (hereinafter "the Board"), which is the agency of the State of California empowered to assess and collect liabilities arising under the California Sales and Use Tax Law.

The petition for review by this Court reflects a lack of respect for the appellate process. As will be developed more fully below, the question which petitioner has placed before this Court was not argued or considered in the courts below. In fact, with a chameleon-like quality, Howell has made a different legal argument in each of the four federal courts in which he has sought relief.

Moreover, in his eagerness to obtain a hearing before this Court, Howell has not only misrepresented applicable California law, but has effectively altered the record to suit his purpose. For example, in his "Statement of the Case," Howell baldly declares that title to property subjected to use taxes by California vested in the United States prior to any use by him as though that were a "fact" established by the record. See Petition for Writ of Certiorari (herein-

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[3]The Bankruptcy Reform Act of 1978 took effect on October 1, 1979. Howell filed bankruptcy proceedings on February 12, 1979.

after "Pet."), at 5; 10-12. On the contrary, the assertion that Howell made no use of the property prior to its transfer to the United States is a legal conclusion which Howell has belatedly reached on his own. The proposition was never considered in the courts below. It is unsupported by the facts of record and is legally indefensible.

The California Sales and Use Tax Law: In General

The California sales tax is imposed on a retailer's gross receipts from the retail sale of tangible personal property within the state. Cal. Rev. & Tax. Code § 6051.[4] Section 6007 defines a "retail sale" as meaning "a sale for any purpose other than resale in the regular course of business in the form of tangible personal property." The term "retailer" is defined in section 6015 as including "[e]very seller who makes any retail sale or sales of tangible personal property." The term "seller" is defined in section 6014 as including "every person engaged in the business of selling tangible personal property of a kind the gross receipts from the retail sale of which are required to be included in the measure of the sales tax."

Section 6201 imposes a complementary use tax on the storage, use or other consumption in California of tangible personal property purchased from a retailer in a transaction not subject to sales tax. Cal. Rev. & Tax. Code § 6401. Generally, use tax rather than sales tax is applicable in one of two situations: (1) where the property has been purchased from an out-of-state retailer; or (2) where the property has been purchased in California under a "resale certificate" but is used by the purchaser prior to resale. See, e.g., *McConville v. State Bd. of Equalization*, 85 Cal.App. 3d 156, 159, 149 Cal. Rptr. 194 (1978).

The use tax is a direct obligation of the purchaser, Cal. Rev. & Tax. Code § 6202, though, under certain circum-

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[4]All statutory references are to the California Revenue and Taxation Code unless otherwise noted.

stances, the retailer may be required to collect it. See, e.g., *National Geographic v. Cal. Equalization Board,* 430 U.S. 551 (1976). In *Diamond National v. State Equalization Bd.,* 425 U.S. 268 (1976), this Court ruled that for purposes of federal immunity, the legal incidence of the sales tax also falls upon the purchaser. The long-held view of the California courts that the legal incidence of the sales tax falls upon the retailer, see, e.g., *Western Lithograph Co. v. State Bd. of Equalization,* 11 Cal.2d 156, 163-164, 78 P.2d 731 (1938), continues to be followed in situations in which a question of federal immunity is not involved. See, e.g., *United States v. State Bd. of Equalization,* 693 F. 2d 458, 465 (9th Cir. 1981), cert. den., 451 U.S. 1028 (1981); *Occidental Life Ins. Co. v. State Bd. of Equalization,* 135 Cal. App. 3d 845, 848-851, 185 Cal. Rptr. 779 (1982).[5]

Application of Sales and Use Taxes Under Regulation 1521

The application of the California Sales and Use Tax Law to construction contractors is set forth in Regulation 1521 (18 Cal. Admin. Code § 1521). This regulation distinguishes between three types of tangible personal property typically used or installed on a construction project: "materials," "fixtures," and "machinery and equipment." Broadly defined, "materials" are items which become an

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[5]Howell's discussion of these general principles is garbled at best. First, he states that the distinguishing characteristic of a "vendee" type tax is that "the seller is statutorily entitled to reimbursement of that tax from the buyer." Pet., at 6. At least insofar as the California use tax is concerned, this is inaccurate. The use tax is a "vendee" type tax for the simple reason that it is a direct obligation of the purchaser. It is not a tax levied on the seller which the law permits or requires the seller to "pass on" to the purchaser.

Second, after having lumped together the California sales and use taxes, Howell states that "Although California has characterized its *tax* as a vendor type tax, this Court has found that, as a matter of federal law, the legal incidence of *the tax* falls upon the vendee." *Id.* (emphasis added). The *Diamond National* case raised a question as to the legal incidence of a *sales tax* levied on a *sale* of

integral part of realty; "fixtures" are items which become an accessory to a structure; and "machinery and equipment" are items which incidentally may be attached to realty but do not lose their identity as tangible personal property when so attached.

The tax treatment with respect to the three types of property described above is as follows:

Both United States and private contractors are regarded as retailers of "machinery and equipment." Accordingly, such property may be purchased by a United States contractor under a resale certificate, and no tax is due on its subsequent transfer to the Federal Government. In all other cases, the transfer of machinery and equipment from a contractor to the project owner constitutes a taxable sale.

Both United States and private contractors are regarded as consumers of "materials."[8] Accordingly, sales tax is due on the sale of the materials to the contractor, or, if such materials have been purchased under a resale certi-

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tangible personal property to a federal instrumentality. The incidence of the use tax is indisputably upon the purchaser, and California has never contended otherwise.

Finally, Howell says that "The difference between the two types of sales and use taxes [i.e., "vendor" and "vendee"] becomes critical when sales to the United States are involved" because "the legal incidence of a vendee type tax falls on the United States. . . ." *Id.* This is correct, of course, only when the taxed transaction *is* a sale to the United States and the United States *is* a vendee. Howell's observation is not germane to the present case since the transaction giving rise to the asserted liability was Howell's purchase of construction materials from his suppliers, not the "purchase" by the United States of the completed improvements.

[8]This has been true since at least 1939, when the first regulation dealing with construction contractors was adopted. Howell's assertion that only United States contractors are classified as consumers of materials, see Pet., at 8, n. 6, is inexplicable.

ficate, use tax is due on the contractor's use of the materials in the performance of his contract.[7]

With respect to "fixtures," which are items accessory to a structure, the regulation provides for dissimilar treatment of United States and private contractors. United States contractors are classified as consumers of this type of property, and therefore the tax applies in the same manner as the tax on materials. Private contractors, on the other hand, are classified as retailers of fixtures; thus, tax applies to the transfer of the fixtures to the project owner rather than to the sale of the fixtures to the contractor.[8]

The distinction made in the regulation between "materials" and "fixtures" was necessitated by the fact that the California Sales and Use Tax Law applies to the sale of tangible personal property, but not to the sale of services. In general, a building contractor is regarded under the law "as a supplier of services and as a consumer of the building material. . . ." *King v. State Bd. of Equalization,* 22 Cal.

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[7]In a narrow exception to the general rule, a private contractor is not regarded as using "materials" in the improvement of real property when he enters into a "time and material" contract which explicitly provides for the transfer of title to materials prior to installation and separately states the sales price of the materials exclusive of the charge for installation. See Reg. 1521(b)(2)(A)(2). Although some "extras" in the present case were billed on a time and material basis, Reporter's Transcript, at 65, all of the contracts were lump-sum contracts and thus of a type to which the general rule would apply in the case of private as well as governmental contractors.

[8]Generally, in either case, the measure of the tax liability is the cost price of the fixture to the contractor. However, the tax may actually be greater in the case of a contractor doing business with a private party. If such a contractor is also the manufacturer of fixtures, he must pay tax on the cost of the labor and overhead involved in the fabrication, see *Oliver & Williams Elevator Corp. v. State Bd. of Equalization,* 48 Cal.App.3d 890, 122 Cal. Rptr. 249 (1975), while a U.S. contractor under similar circumstances would pay tax only on the cost of materials used in the fabrication.

App. 3d 1006, 1013, 99 Cal. Rptr. 802 (1972); see also *Levine v. State Bd. of Equalization,* 142 Cal.App.2d 760, 768, 299 P.2d 738 (1956); *Gen. Elec. Co. v. State Bd. of Equalization,* 111 Cal.2d 180, 187, 244 P.2d 427 (1952). A contractor may, however, make incidental sales of tangible personal property. It is thus necessary to draw a line between tangible personal property which is sold by a contractor to the project owner and tangible persomal property which is used by him in the rendition of services. This line is drawn by the provisions of Regulation 1521 distinguishing between "materials" which become an integral part of the realty and "fixtures" which become an accessory to a structure.

The differential treatment accorded U.S. and private contractors with the respect to fixtures is based on section 6384 of the California Revenue and Taxation Code, enacted in its original form in 1941. This provision imposes the sales tax "on gross receipts from the sale of *any* tangible personal property to contractors purchasing such property . . . for use in the performance of contracts with the United States for the construction of improvements on or to real property." (Emphasis added.) It therefore accounts for the rule that a United States contractor is a consumer not only of "materials," but of "fixtures" as well.[9]

Regulation 1521 and its predecessors have been repeatedly upheld by the California courts as properly interpreting the statutory provisions in relation to the construction industry. See, e.g., *Gen. Elec. Co. v. State Bd. of Equalization, supra,* 11 Cal.App.2d 180; *Coast Elevator Co. v. State Bd. of Equalization,* 44 Cal.App.3d 576, 118 Cal. Rptr.

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[9]In 1941, the Legislature also provided that "a sale of tangible personal property to a contractor or subcontractor for use in the performance of contracts with the United States for the construction of improvements on or to real property is hereby declared to be a retail sale. . . ." States. 1941, chp. 681, § 9. This provision was incorporated into the Revenue and Taxation Code in 1955 as section 6007.5.

818 (1975); *Honeywell Inc. v. State Bd. of Equalization*, 48 Cal.App. 3d 907, 122 Cal. Rptr. 243 (1975).

The Tax Assessment Against Howell

Howell is an electrical contractor who has been operating under Chapter XI of the former Bankruptcy Act since early 1979. On June 22, 1979, the Board filed Proof of Priority Claim for Taxes in the Chapter XI proceeding. This claim asserted a deficiency under the California Sales and Use Tax Law in the amount of $71,502.34 tax plus interest for the audit period commencing April 1, 1976 and ending February 12, 1979. The asserted liability was calculated on a measure of $1,777,381.00 plus a BART (Bay Area Rapid Transit) tax measure of $171,896.00. Stipulation of Facts, ¶ 1. The $1,777,380.00 figure has since been reduced by $64,661.00. Stipulation of Facts, ¶ 7.

During the audit period covered by the deficiency determination, Howell performed numerous subcontracts for improvement of real property belonging to the United States, and acted as prime contractor on two government projects. Stipulation of Facts, ¶ 4. Tangible personal property which had been used in performing such contracts was purchased by Howell tax free ("ex tax") from various suppliers under resale certificates. Stipulation of Facts, ¶ 1. The asserted deficiency relates to use taxes alleged to be due on the items so purchased.

It is stated in the petition for review that the stipulation of facts entered into by the parties in the Bankruptcy Court "describes in detail the contractual provisions for ownership of the tangible personal property involved in each contract, as well as the federal government's complete control over Howell's activities as a contractor." Pet., at 10. As Howell is well aware, this representation to the Court is untrue.

The only stipulation of the parties bearing on title to the property is contained in Paragraph 15 of the Stipulation of the Facts. This paragraph reads in its entirety as follows:

> "On or about February 12, 1979, Howell was in default of his contractual obligation in the performance of electrical installation contracts on three of the projects listed in Paragraph 4. The parties agree that certain materials purchased by Howell and in inventory at the site of construction were not installed by Howell but passed from Howell's control to the prime contractor prior to installation pursuant to the terms of the respective prime or subcontracts. The Board has asserted in its determination a tax of $7,097.00 on the above described inventory of materials, calculated on a measure of $116,867. Howell contends that the transfer of the inventory from Howell's control to the prime contractor was a sale for resale to the United States Government or, in the alternative, that the Board improperly taxed the material because title thereto was transferred to the United States Government prior to any use by Howell. A copy of the typical title clause included in said prime or subcontracts is attached hereto as Exhibit C."

Exhibit C is of a one-page printed document containing various "boilerplate" provisions commonly included in government contracts. The title clause therein (with underscoring provided by the parties) reads as follows:

> "*All material and work covered by progress payments shall thereupon become the sole property of the Government.* This provision shall not be construed as relieving the Contractor of the sole responsibility for all material and work upon which payments have been made or the restoration of any damaged work, [word illegible] the right of the Government to require the fulfillment of the terms of the contract."

There were no stipulations between the parties regarding the title provisions of any contracts other than those mentioned in Paragraph 15. There were no stipulations at all regarding the control of the United States over Howell's activities. In addition, while all of Howell's contracts "are referenced in" the Stipulation of Facts, see Pet., at 10, n. 8, the record does not contain a copy of Contract No. IFB N62474-76-B7685 ("Job No. 101"), to which Howell makes repeated reference at pages 10-11 of the petition. In fact, with the narrow exception noted above, the record does not contain a copy or recitation of *any* contractual provisions.

Howell also refers to another "fact" which is not of record. He says at page 10 of the petition that he issued a resale certificate to each of his suppliers "indicating that [he] would be reselling the property *to the United States.*" (Emphasis added.) There is no evidence that the United States was mentioned in the resale certificates. The record does include testimony of the auditor to the effect that delivery instructions contained in invoices indicated that Howell generally purchased materials for use on a particular construction project. Reporter's Transcript, at 56. Thus, while Howell was aware that the property was to be used in improving real property belonging to the United States, it is far from clear that his suppliers were privy to that information.

Arguments and Disposition Below

Howell has now sought relief from the Board's assessment in four federal courts, including this one. On each occasion, he has asserted a different legal argument in support of his claim that the treatment of United States contractors under the California Sales and Use Tax Law violates the Supremacy Clause.

In the Bankruptcy Court, Howell argued that the California law unconstitutionally discriminates against U.S. contractors with respect to "fixtures" because U.S. and pri-

vate contractors are treated differently. He conceded, however, that the law does not discriminate against U.S. contractors with respect to the purchase of "materials" since U.S. contractors and private contractors are treated alike. The Bankruptcy Court, declining to accept the concession of Howell, held that the California law unconstitutionally discriminates against U.S. contractors was respect to *both* materials and fixtures. This holding was based on a broad misinterpretation of the statutory provisions as permitting a private contractor to recoup the tax from the project owner as part of the contract price, but prohibiting a governmental contractor from doing the same.

Buoyed by this success in the Bankruptcy Court, but unable to cope with that court's unsupportable conclusion that U.S. contractors are treated differently than private contractors with respect to materials, Howell asserted in the District Court that *only U.S. contractors were properly treated as consumers of materials under the statutory provisions.* See Brief for the Appellee, United States District Court, at 23-26. This theory supplied Howell with the same differential treatment (private contractors as retailers, U.S. contractors as consumers) which he had thus far successfully argued was unconstitutionally discriminatory in the case of fixtures.

The notion that the California law discriminates against U.S. contractors because of differential treatment became untenable when this Court issued its decision in *Washington v. United States,* 103 S. Ct. 1344 (1983). In that case, the State of Washington taxed a United States contractor as a consumer of materials going into a construction project while treating his counterpart in the private sector as making a sale of the completed improvement to the project owner. This Court upheld the Washington law, saying that "The important consideration . . . is not whether the State differentiates in determining what entity shall bear the legal incidence of the tax, but whether the tax is discrimi-

natory with regard to the economic burdens that result." 103 S. C., at 1349.

In light of the controlling authority of the *Washington* case, Howell dropped his discrimination argument in the Ninth Circuit Court of Appeals. He there contended that Regulation 1521 is invalid because there is *no statutory authority for treating U.S. contractors as consumers of either materials or fixtures*. See Opening Brief of Debtor-Appellant, Ninth Circuit Court of Appeals, at 13-16.[10] From this premise, he reasoned that the taxes in question were actually imposed on his "sale" of materials and fixtures to the United States, and that, since for federal purposes the incidence of the *sales tax* is on the purchaser, the asserted taxes were imposed directly on the United States. *Id.*, at 8, 12, 15-16; see also Reply Brief of Debtor-Appellant, Ninth Circuit Court of Appeals, at 9-10. While noting that this contention had not been made below, the Court of Appeals elected to consider its merits. 731 F. 2d, at 626-627. The court found the contention groundless, pointing out that "The transaction between Howell and the United States is not taxed at all; the tax is imposed on the transfer of property from a supplier to Howell." *Id.*, at 628.[11]

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[10]Howell has not sought review of this question in his Petition for Writ of Certiorari, see Pet., at 13, n. 13, but he obviously remains unconvinced that there is statutory authority for the regulation's classification of U.S. contractors as "consumers" of materials and fixtures. See Pet., at 8, n. 6. A U.S. contractor is identified in the regulation as a "consumer" of materials and fixtures for the simple reason that the sale of such property to the contractor is deemed to be a "retail sale"—i.e., the contractor is regarded as purchasing the property for use rather than for resale. Furthermore, as noted by the Court of Appeals, "since the regulation accurately describes the tax consequences of the California Sales and Use Tax Law, the particular word chosen to describe the contractor is immaterial." 731 F. 2d, at 628.

[11]Howell criticizes the latter statement of the Court of Appeals, saying that it "would seem to describe the imposition of a *sales* tax —not a use tax." Pet., at 13 (emphasis in original). He thus con-

By way of a petition for rehearing in the Court of Appeals, Howell sought to raise for the first time the theory which he now advances in this Court: that he was not the owner of the property at the time of its use and therefore the asserted tax is a *use tax* imposed directly on the United States. It was stated in the petition for rehearing that "Howell has argued that title was transferred to the United States before the property was used," and that [i]n order to prevent confusion the court should meet [this argument] squarely. . . ." Petition for Rehearing, Ninth Circuit Court of Appeals, at v. Howell, however, had not made the argument in the Court of Appeals. He had not made the argument in the District Court. He had not made the argument in the Bankruptcy Court, *except with respect to a minor portion of materials which had been left at job sites when the Chapter XI proceedings were instituted.* See, *supra* at 10. Even in this limited context, the question was never reached by the Bankruptcy Court due to its holding that the tax on materials was invalid in its entirety.

REASONS WHY THE WRIT SHOULD BE DENIED

I

THE QUESTION WHICH HOWELL HAS PRESENTED FOR CONSIDERATION BY THIS COURT WAS NOT ARGUED OR CONSIDERED IN THE COURTS BELOW.

This Court has repeatedly indicated its unwillingness to consider questions not raised in the courts below. See, e.g., *G.D. Searle & Company v. Cohn*, 102 S. Ct. 1137, 1143, n.7 (1982); *Delta Air Lines, Inc. v. August*, 450 U.S. 356, 362

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cludes that the Court of Appeals misunderstood the situation. See also Pet., at 15. On the contrary, the court properly recognized that the transfer giving rise to the asserted tax liability was the transfer of property *to*, not *from*, Howell. A sales tax would have been applicable to that transfer had Howell not improperly certified to his suppliers that he was purchasing the property for resale.

(1981); *United States v. Ortiz*, 422 U.S. 891, 898 (1975); *Adickes v. Kress & Co.*, 398 U.S. 144, 147, n. 2 (1970). As detailed immediately above, the question which Howell has framed for this Court's consideration first saw the light of day in his Petition for Rehearing by the Ninth Circuit. The question was not argued in the Court of Appeals, and consequently was not considered by it. Nor did Howell raise the present question in either the Bankruptcy Court or the District Court.

In an attempt to avoid this difficulty with his petition for review, Howell implies that he has consistently argued that the asserted tax is a "direct tax" against the United States. See Pet., at 12-13. As the Court of Appeals observed, however, while Howell made reference to such an issue in his pretrial statement, he did not argue the point in either the Bankruptcy Court or the District Court. 731 F. 2d, at 626, n. 1. Furthermore, even in the Court of Appeals, he argued a different theory than he does now. There he contended that the asserted tax was a "direct tax" on the United States not because the property was owned by the United States at the time of its use by Howell, but because the tax was levied on a "sale" of the property to the United States, with the incidence of the tax falling upon the United States as purchaser.

Surely, a litigant's use of "buzz words," such as Howell's on-again-off-again references to a "direct tax," does not give him the license to freely change his legal theories from one court to another and to seek "review" of questions that have not been previously considered and ruled upon. That was the clear indication of this Court in the *Searle* case, where the petitioner attempted to make a new due process argument in this Court after having made another due process argument in the courts below. The Court refused to address the new argument. See 102 S. Ct., at 1143, n. 7.

II

FAR FROM PRESENTING AN IMPORTANT QUESTION OF LAW, THE CASE DOES NOT EVEN RAISE THE ISSUE THAT HOWELL WANTS DECIDED.

In *United States v. New Mexico,* 455 U.S. 720 (1982), this Court ruled that a state's assessment of use taxes against a U.S. contractor was constitutionally permissible even though title to the property was held by the United States. Howell contends that it is important for this Court to go further and determine whether such an assessment is permissible when the United States is the owner of the property at the time of its use and the taxing state purports to levy only a "title-based use tax." That question, however, is not presented in the case at hand.

A. Title to the Property at Issue Here Did not Vest in the United States Prior to Its Use by Howell.

Howell's present claim that the taxes asserted by California constitute a direct tax on the United States is premised on his conclusion that title to the property vested in the United States prior to any use by him. In this regard, it is asserted in the petition for writ of certiorari that,

> ". . . the United States acquired title to the personal property installed by Howell at the *earliest* of two dates: (i) pursuant to the contractual provisions, when the Government made its initial progress payment, or (ii) by law, when Howell first attached the personal property to the Government's real property.
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> "Regardless of the precise time when title vested in the United States, one point remains clear: Title vested well before use by Howell." Pet., at 10-11 (emphasis in original).

As will be explained below, Howell made a taxable use of the property immediately upon its purchase because, though he purchased that property under resale certificates, it was never held by him for purposes of resale. Even

if the applicable statutory provisions could not be construed as reaching such an immediate use, by no stretch of the imagination can Howell's use of the property be regarded as occurring *after* his receipt of progress payments, or *after* he attached the property to realty belonging to the United States.

Section 6007.5 of the California Sales and Use Tax Law provides, in relevant part, that "A sale of tangible personal property to a contractor or subcontractor for use in the performance of contracts with the United States for the construction of improvements on or to real property in this State is a *retail sale*." (Emphasis added.) Howell chose to disregard this statutory provision and to purchase property from his suppliers under certificates stating that the property was being purchased for resale. Section 6094, subsection (a), of the California law provides that "If a purchaser who gives a resale certificate makes any use of the property other than retention, demonstration, or display while holding it for sale in the regular course of business, the use shall be taxable to the purchaser . . . as of the time the property is first used by him. . . ." See also § 6094.5.

It is unadulterated nonsense for Howell to contend that he made no taxable use of the property in question when he used it to improve real property belonging to the United States—the very use contemplated by section 6007.5. Evidently realizing that he is on shaky grounds, Howell resorts to a fall-back position: that, prior to any use by him, title to the property passed to the United States under the progress payment clause applicable to his contracts. This clause provided that "All material and work covered by progress payments shall thereupon become the sole property of the Government." Exhibit C to Stipulation of Facts, ¶ 15.[12] But it, too, creates problems for Howell. The clause

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[12]It is assumed, *arguendo*, that this clause was applicable to all of Howell's contracts. Actually, the stipulation referring to the progress payment clause pertained only to *three* of his contracts. See *supra*, at 10.

refers to "material *and* work" covered by progress payments and appears to contemplate that title to improvements will vest in the United States as construction proceeds. In any event, how can Howell logically argue that the clause precludes taxation of materials which have been used for construction purposes prior to receipt of a corresponding progress payment?

Howell attempts to solve the latter dilemma by audaciously inserting the word "initial" in his paraphrasing of the clause, asserting that title to the property passed to the United States "when the Government made its *initial* progress payment." Pet., at 10-11 (emphasis added); see also Pet., at 16 ("title passed [to the United States] at the time of the *initial* progress payment") (emphasis added); Pet., at 18 ("the use was that of the federal government in which title vested, either after the *initial* progress payment was made by the United States or after the first instant that Howell attached the personal property to the Government's realty") (emphasis added). Howell thus expects this Court to accept the proposition that once the "initial" progress payment was made, the United States became the owner of all materials to be used thereafter on the construction project. The payment clause itself provides otherwise.

Howell also talks about "the federal government's complete control over [his] activities, Pet., at 10,[13] and he asserts that this control, together with the progress payment

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[13]As previously pointed out, see *supra*, at 11, contractual provisions relating to the Government's control over Howell's activities were not the subject of a stipulation between the parties and the contract to which Howell refers (i.e., the contract for "Job 101") is not in evidence. Exhibit C to Stipulation of Facts, ¶ 15, which was agreed to contain the title clause included in three of Howell's contracts, also contains "boilerplate" provisions which appear to correspond to some of the provisions which Howell attributes to the contract for Job 101. There is at least one notable exception. Citing ¶ 9 of the Job 101 contract, Howell states that "before Howell could purchase personal property from its suppliers, the

clause, "clearly indicates that the United States regarded itself as the purchaser and owner of all personal property used by Howell." *Id.*, at 11. Several comments are in order. *First*, the contracts considered by this Court in *United States v. New Mexico, supra*, gave the Government control over all property purchased under the contracts, as well as over each contractor's property management procedures. 455 U.S., at 725. These facts were not considered indicative of an agency relationship between the United States and the contractors. *Second*, it has been the official policy of the Department of Defense since 1955 to *discourage* the use of agency provisions in its contracts.[14] See Defense Procurements Circular No. 76-8, pertinent excerpts of which are

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United States had to give Howell or Howell's prime contractor formal approval." Pet., at 11. This characterization of paragraph ¶ 9 of the contract does not jibe with the same numbered paragraph in Exhibit C, which reads, in relevant part:

"When required by this contract or when called for by the Contracting Officer, the Contractor shall furnish the Contracting Officer for approval full information concerning the material or articles which he contemplates incorporating in the work. When so directed, samples shall be submitted for approval at the Contractor's expense, with all shipping charges prepayed. Machinery, equipment, material, and articles installed or used without required approval shall be at the risk of subsequent rejection."

These provisions relate to quality control, and furthermore are operative only "when required by [the] contract or when called for by the Contracting Officer." It is unknown whether they pertained to the Job 101 contract or to any other contracts of Howell. Under such circumstances, if this Court were to grant the petition for review, and if the Board were expected to respond fully to Howell's contentions regarding the Government's control over his activities, presumably some mechanism would have to be provided for the introduction of additional evidence.

[14]The construction projects on which Howell performed electrical work included projects at Castle Air Force Base, Moffett Field, McClellan Air Force Base, Mare Island Naval Shipyard, and the U.S. Naval Air Station at Alameda, California. Stipulation of Facts. ¶ 4.

contained in the Appendix. It would thus seem strange to interpret the provisions discussed by Howell as being intended to create an agency relationship by implication. *Third,* if Howell is correct in asserting that the United States regards itself as the purchaser and owner of property that is subject to such contract provisions, it is remarkable that the California use tax has been applied to United States contractors without complaint by the Federal Government for nearly half a century. By contrast, the Federal Government sought injunctive relief against the legislation considered in *Washington v. United States, supra,* shortly after it was enacted. 103 S. Ct., at 1347.

B. Howell Made a Taxable Use of the Property When He Acquired and Held It For Purposes Other Than Resale.

Howell concedes, as he must, that the sales to him of property to be used in improving real property belonging to the United States were sales at retail under California law. See, e.g., Pet., at 8 ("[Sections 6007.5 and 6384] tax the transaction between the supplier and the government contractor as a retail sale"). A sale at retail is defined as meaning "a sale for any purpose *other than resale* in the regular course of business in the form of tangible personal property." (Emphasis added.) Since Howell goes on to assert that "[he] had no purpose in purchasing personal property from suppliers other than the eventual resale of that property to the federal government," Pet., at 18, it is apparently his notion that the sales of construction supplies to him were not *only* sales at retail but *also* sales for resale. This is absurd on its face. Under the California law, a sale of tangible personal property is either a retail sale *or* a sale for resale; it cannot be both.

Following the same line of reasoning, Howell professes to be bewildered by the Board's tax assessment, stating that "Why the Board determined to ignore[section 6007.5] and

impose an illegal use tax on Howell is . . . a mystery." Pet., at 18. See also Pet., at 8 ("Here, the Board—for unknown reasons—has determined not to follow its own statutes and impose a sales tax on Howell's suppliers under section 6007.5"); Pet., at 15 ("Even the Board acknowledges that it did not follow California's own statutory scheme by levying a sales tax on Howell's suppliers").[15]

The solution to the "mystery" is not in the least bit complicated. A purchaser who executes a resale certificate makes the representation that he is purchasing the particular property for the purpose of reselling it in the regular course of his business, and he thereby escapes reimbursing the seller for sales tax at the time of purchase. Thus, a resale certificate is properly used only when the purchaser knows at the time of purchase that the property will be resold in the regular course of business or does not know at that time whether the property will be resold or used. See *McConville v. State Bd. of Equalization, supra,* 142 Cal. App.2d, at 766. Where, on the other hand, a purchaser intends to use the property rather than resell it, the sale to him is a retail sale, *Standard Oil v. State Bd. of Equalization,* 232 Cal.App.2d 91, 95, 91 Cal.Rptr. 543 (1965), and the issuance of a resale certificate is improper. Under the latter circumstances, *any* exercise of dominion over the property will give rise to an immediate tax liability since the property is not held for resale in the regular course of business. Cal.Rev. & Tax Code §§ 6094, 6094.5.

Howell misinterprets these provisions of the California law when he claims that his use of the property was not

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[15]Howell also says that "the Board could have taxed Howell's suppliers under section 6007.5 regardless of Howell's issuance of resale certificates." Pet., at 18. This claim is contradicated by his own admission that "a purchaser can relieve the seller from liability for sales tax by giving the seller a resale certificate indicating that the personal property is to be resold by the purchaser." Pet., at 7. That is precisely the type of certificate which Howell gave to his suppliers in the case at hand.

"incident to ownership." Sections 6007.5 and 6384 specifically define as a taxable event the purchase by a contractor of property to be used in improving realty belonging to the United States. When such property is improperly acquired under a resale certificate, and the contractor exercises any dominion over it (including mere "storage" as defined in section 6008), he is making a use of that property incident to his ownership. Furthermore, section 6094.5, subsection (b), specifically provides that "[a]ny person who gives a resale certificate for property which he knows at the time of purchase is not to be resold by him in the regular course of business is liable to the state for the amount of tax that would be due if he had not given such resale certificate."[16]

It is further asserted that the California taxing scheme "all but compels Howell to collect the [use] tax from the owner of [the] property, the United States." Pet., at 18. The concept that Howell is talking about here comes into play when the United States is a party to the taxed transaction. See *Diamond National v. State Equalization Bd., supra,* 430 U.S. 551. In the present case, the State of California has not taxed the transaction between Howell and the United States, but rather has imposed a use tax against Howell based on his transactions with third parties.

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[16]Use taxes imposed on United States contractors on the basis of this absolute liability with respect to purchases at retail are substantially equivalent to the use taxes unanimously upheld by this Court in *United States v. New Mexico, supra.* It is also to be noted that the distinction drawn by Howell between a "possessory use tax" and a "title-based use tax" is reminiscent of the effort of the United States in *New Mexico* to distinguish between the "privilege type use tax" involved in *United States v. Boyd,* 378 U.S. 39 (1964) and the "compensating use tax" imposed by New Mexico. 455 U.S. at 738-739, n. 12. This Court found that the two taxes had the same practical operation and effect, stating:

> "Both taxes in terms reach the *use* of property; both have the effect of serving as enforcement mechanisms for the state

III

THE ALLEGED CONFLICT IN CASE AUTHORITY IS NONEXISTENT.

Howell contends that review is warranted in this case because the decision of the Court of Appeals conflicts with another decision in the *same* circuit, *United States v. Nevada Tax Commission,* 291 F. Supp. 530 (D. Nev. 1968), aff'd 439 F. 2d 435 (9th Cir. 1971), as well as with the decision of the First Circuit in *Federal Reserve Bank v. Commissioner of Corporations and Taxation,* 520 F. 2d 221 (1st Cir. 1975). The contention is without merit.

In the *Nevada* case, a U.S. contractor (Recco) was assessed use taxes on tangible personal property that had been used in performing a contract for the Atomic Energy Commission. Recco was engaged "in rendering construction, maintenance and operation, health, medicine and safety, and architect-engineering services to the AEC in connection with its operation and maintenance of the [Nevada Test] Site." 291 F. Supp., at 532. The only supplier mentioned in the case was Cashman Equipment Co. In setting forth the facts, the District Court noted that,

> "None of the property which was purchased from Cashman was purchased or resold for use or used in constructing improvements on or to real property. . . ." *Id.*

Thus, while it is true that the State of Nevada has a statute similar to section 6384 of the California Revenue and Taxation Code, that statute was not in issue in the *Nevada* case. It was not even mentioned in the District Court opinion.

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sales tax. Both serve to ensure that either the sale or the use of all property in the hands of non-immune entities will be taxed, no matter where the property is purchased." *Id.* (emphasis in original).

In addition, the contract involved in the *Nevada* case specifically provided that title to property to be used in performing the contract "shall pass directly from the vendor to the Government." *Id.* Thus, Recco, unlike Howell, *never* held title to the property in question.

Similarly, in the *Federal Reserve Bank* case, "[t]he contract [with the federal instrumentality] provided that title to all . . . materials was to pass directly from the vendor to the Government and that the contractor, who was required to furnish all materials, was acting as the purchasing agent for the Government in making arrangements for delivery of these items." 520 F. 2d, at 224. While the contract in that case did involve improvements to real property, there is no indication in the opinion that the State of Massachusetts had any statutes comparable to those of California expressly dealing with construction contracts.

Howell has also cited three state cases. See Pet., at 19. In both *General Motors Corp. v. State Com'n of Rev. & Tax.*, 182 Kan. 237, 320 P. 2d 807 (1958), cert. den., 358 U.S. 875 (1968) and *Avco Manufacturing Corp. v. Connelly,* 145 Conn. 161, 140 A. 2d 479 (1958), it was determined that the contractors had never held title to the property. In *State Tax Commission v. Graybar Electric Co.,* 86 Ariz. 253, 344 P. 2d 1008 (1959), it was determined that certain equipment had either been purchased by the contractor as agent of the United States or for resale purposes. None of the cases appear to have involved improvements to real property or statutes comparable to sections 6007.5 and 6384.

Howell nevertheless insists that the decision of the Court of Appeals is inconsistent with previous case authority and will throw the construction industry into turmoil. He states:

> "[The decision] prevents government contractors from properly allocating construction costs. It adds hidden costs to the contractor's services and the Gov-

> ernment's contract price. It threatens the predictability of bidding for, entering into, and performing construction contracts for the United States." Pet., at 22.

This is a facetious claim in the context of the present case. In the first two quarters of the tax period involved, Howell had purchased his materials on a tax-paid basis, and was therefore aware of the potential tax liability. Reporter's Transcript, at 23. Moreover, since Howell conceded in the Bankruptcy Court that he was liable for use taxes on materials (as distinguished from "fixtures") which he had purchased on an ex-tax basis, see *supra* at 12, it seems likely that he took such taxes into account in setting his contract prices. If he did not take the potential taxes into account, this may at least partially explain why he was able to underbid his competitors and thereby receive the Government's business in the first place.

CONCLUSION

Howell has not offered any legitimate basis for a review by this Court. Accordingly, the petition for writ of certiorari should be denied.

October 8, 1984.

Respectfully submitted,

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(Appendices follow)

Appendix A

State of California

BOARD OF EQUALIZATION

SALES AND USE TAX REGULATIONS

Regulation 1521. CONSTRUCTION CONTRACTORS.

References: Sections 6006-6010, 6012, 6012.2, 6012.8, 6012.9, 6015, 6016.3, 6016.5, 6054.5, 6055, 6091-6095, 6203.5, 6241-6246, 6276, 6276.1, 6379, 6384, 6386, 6421, 6901.5, Revenue and Taxation Code.

TABLE OF SUBTITLES

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Appendix B—Typical Items Regarded as Fixtures
Appendix C—Typical Items Regarded as Machinery and Equipment and Items Not Regarded as Machinery and Equipment

(a) DEFINITIONS

(1) CONSTRUCTION CONTRACT

(A) "Construction contract" means and includes a contract, whether on a lump sum, time and material, cost plus, or other basis, to:

1. Erect, construct, alter, or repair any building or other structure, project, development, or other improvement on or to real property, or

2. Erect, construct, alter, or repair any fixed works such as waterways and hydroelectric plants, steam and atomic electric generating plants, electrical transmission and distribution lines, telephone and telegraph lines, railroads, highways, airports, sewers and sewage disposal plants and systems, waterworks and water distribution systems, gas transmission and distribution systems, pipelines and other systems for the transmission of petroleum and other liquid or gaseous substances, refineries and chemical plants, or

3. Pave surfaces separately or in connection with any of the above works or projects, or

4. Furnish and install property becoming a part of a central heating, air-conditioning, or electrical system of a building or other structure, and furnish and install wires, ducts, pipes, vents, and other conduit imbedded in or securely affixed to the land or a structure thereon.

(B) "Construction contract" does not include:

1. A contract for the sale or for the sale and installation of tangible personal property such as machinery and equipment, or

2. The furnishing of tangible personal property under what is otherwise a construction contract if the person furnishing the property is not responsible under the construction contract for the final affixation or installation of the property furnished.

(2) CONSTRUCTION CONTRACTOR. "Construction contractor" means any person who for himself, in conjunction with, or by or through others, agrees to perform and does perform a construction contract. "Construction contractor" includes subcontractors and specialty contractors and those engaged in such building trades as carpentry, bricklaying, cement work, steel work, plastering, drywall installation, sheet metal work, roofing, tile and terrazzo work, electrical work, plumbing, heating, air-conditioning,

elevator installation and construction, painting, and persons installing floor coverings, including linoleum, floor tile, and wall-to-wall carpeting, by permanently affixing such coverings to a floor.

(3) UNITED STATES CONSTRUCTION CONTRACTOR. "United States construction contractor" means a construction contractor who for himself, in conjunction with, or by or through others, agrees to perform and does perform a construction contract for the United States Government.

(4) MATERIALS. "Materials" means and includes construction materials and components, and other tangible personal property incorporated into, attached to, or affixed to, real property by contractors in the performance of a construction contract and which, when combined with other tangible personal property, loses its identity to become an integral and inseparable part of the real property. A list of typical items regarded as materials is set forth in Appendix A.

(5) FIXTURES. "Fixtures" means and includes items which are accessory to a building or other structure and do not lose their identity as accessories when installed. A list of typical items regarded as fixtures is set forth in Appendix B.

(6) MACHINERY AND EQUIPMENT. "Machinery and equipment" means and includes property intended to be used in the production, manufacturing or processing of tangible personal property, the performance of services or for other purposes (e.g., research, testing, experimentation) not essential to the fixed works, building, or structure itself, but which property incidentally may, on account of its nature, be attached to the realty without losing its identity as a particular piece of machinery or equipment and, if attached, is readily removable without damage to the unit or to the realty. "Machinery and equipment" does not

include junction boxes, switches, conduit and wiring, or valves, pipes, and tubing incorporated into fixed works, buildings, or other structures, whether or not such items are used solely or partially in connection with the operation of machinery and equipment, nor does it include items of tangible personal property such as power shovels, cranes, trucks, and hand or power tools used to perform the construction contract. A list of typical items regarded as machinery and equipment together with a list of typical items not regarded as machinery and equipment is set forth in Appendix C.

(7) TIME AND MATERIAL CONTRACT. "Time and material contract" means a contract under which the contractor agrees to furnish and install materials or fixtures, or both, and which sets forth separately a charge for the materials or fixtures and a charge for their installation or fabrication.

(8) LUMP SUM CONTRACT. "Lump sum contract" means a contract under which the contractor for a stated lump sum agrees to furnish and install materials or fixtures, or both. A lump sum contract does not become a time and material contract when the amounts attributable to materials, fixtures, labor, or tax are separately stated in the invoice.

(b) APPLICATION OF TAX.

(1) UNITED STATES CONSTRUCTION CONTRACTORS.

(A) Materials and Fixtures. United States construction contractors are consumers of materials and fixtures which they furnish and install in the performance of contracts with the United States Government. Either the sales tax or the use tax applies with respect to sales of tangible personal property (including materials, fixtures, supplies, and equipment) to contractors for use in the performance of contracts with the United States for the construction of improve-

ments on or to real property in this state. The fact that the contract may provide principally for the manufacture or acquisition of tangible personal property is immaterial. The sales tax, but not the use tax, applies even though the contractor purchases the property as the agent of the United States.

(B) Machinery and Equipment. United States contractors are retailers of machinery and equipment furnished in connection with the performance of a construction contract with the United States Government. Tax does not apply to sales of machinery and equipment to United States contractors or subcontractors, provided title to the property passes to the United States before the contractor makes any use of it. Such sales are sales for resale, and the purchasing contractor may issue a resale certificate. A contractor who uses the machinery or equipment before title passes to the United States is the consumer of that machinery or equipment and either sales tax or use tax applies with respect to the sale to or the use by the contractor.

(2) CONSTRUCTION CONTRACTORS OTHER THAN UNITED STATES CONSTRUCTION CONTRACTORS

(A) Materials.

1. In General. Construction contractors are consumers of materials which they furnish and install in the performance of construction contracts. Either sales tax or use tax applies with respect to the sale of the materials to or the use of the materials by the construction contractor.

2. When Contractor is Seller. A construction contractor may contract to sell materials and also to install the materials sold. If the contract explicitly provides for the transfer of title to the materials prior to the time the materials are installed, and separately states the sale price of the materials, exclusive of the charge

for installation, the contractor will be deemed to be the retailer of the materials.

In the case of a time and material contract, if the contractor bills his customer an amount for "sales tax" computed upon his marked up billing for materials, it will be assumed, in the absence of convincing evidence to the contrary, that he is the retailer of the materials.

If the sale occurs in this state, the sales tax applies to the contractor's (retailer's) gross receipts from the sale of the materials. If the sale occurs prior to the time the property is brought into this state, the contractor's (retailer's) customer is the consumer and his use (unless otherwise exempt) is subject to use tax measured by the sales price. The contractor must collect the use tax and pay it to this state.

(B) Fixtures.

1. In General. Construction contractors are retailers of fixtures which they furnish and install in the performance of construction contracts and tax applies to their sales of the fixtures.

2. Measure of Tax.

a. In General. If the contract states the sale price at which the fixture is sold, tax applies to that price. If the contract does not state the sale price of the fixture, the sale price shall be deemed to be the cost price of the fixture to the contractor.

b. Determining Cost Price. If the contractor purchases the fixtures in a completed condition, the cost price is deemed to be the sale price of the fixture to him and shall include any manufacturer's excise tax or import duty imposed with respect to the fixture prior to its sale by the contractor.

If the contractor is the manufacturer of the fixture, the cost price is deemed to be the price at

which similar fixtures in similar quantities ready for installation are sold by him to other contractors.

If similar fixtures are not sold to other contractors ready for installation, then the cost price shall be deemed to be the amount stated in the price lists, bid sheets or other records of the contractor.

If the sale price cannot be established in the above manner and the fixture is manufactured by the contractor, the cost price shall be deemed to be the aggregate of the following:

(1) Cost of materials, including such items as freight-in and import duties,

(2) Direct labor, including fringe benefits and payroll taxes,

(3) Specific factory costs attributable to the fixture,

(4) Any manufacturer's excise tax,

(5) Prorata share of all overhead attributable to the manufacture of the fixture, and

(6) Reasonable profit from the manufacturing operations which, in the absence of evidence to the contrary, shall be deemed to be 5 percent of the sum of the preceding factors.

Jobsite fabrication labor and its prorated share of manufacturing overhead must be included in the sale price of the fixture. Jobsite fabrication labor includes assembly labor performed prior to attachment of a component or a fixture to a structure or other real property.

3. Exceptions—Leased Fixtures. In some instances the construction contractor may furnish and install a fixture for a person, other than the owner of the realty, who intends to lease the fixture in place as

tangible personal property as provided in Section 6016.3 of the Revenue and Taxation Code and pay tax measured by rental receipts.

In this case the construction contractor may take a resale certificate from the lessor at the time of the transaction and the sale to the lessor will be considered to be a sale for resale. The resale certificate should indicate that the fixture is purchased for resale by the purchaser as tangible personal property under Section 6016.3 of the Revenue and Taxation Code.

(C) Machinery and Equipment.

1. In General. Construction contractors are retailers of machinery and equipment even though the machinery and equipment is furnished in connection with a construction contract. Tax applies to the contractor's gross receipts from such sales.

2. Measure of Tax.

a. In General. Tax applies to the gross receipts from the sale of machinery and equipment furnished and installed by a construction contractor. If the contract calls only for the furnishing and installation of machinery and equipment, tax applies to the total contract price less those charges excludible from gross receipts under Section 6012 of the Revenue and Taxation Code.

b. Lump Sum Contracts—Determining Gross Receipts. If the contract is for a lump sum and includes the furnishing and installation of materials, fixtures, and machinery and equipment, the gross receipts from the sale of the machinery and equipment shall be the price at which similar quantities ready for installation are sold at retail delivered in the market area where the installation takes place.

If there is no such retail price for the machinery and equipment, then the gross receipts shall be determined from the contracts, price lists, bid sheets, or other records of the contractor.

If the gross receipts cannot be established in the above manner and the machinery and equipment is manufactured by the contractor, the gross receipts from the sale shall be the aggregate of the following:

(1) Cost of materials, including such items as freight-in and import duties,

(2) Direct labor, including fringe benefits and payroll taxes,

(3) Specific factory costs attributable to the machinery or equipment,

(4) Any manufacturer's excise tax,

(5) Prorata share of all overhead attributable to the machinery or equipment, including overhead attributable to manufacturing, selling, contracting, and administration, and

(6) Reasonable profit from the manufacture and sale of the machinery or equipment which, in the absence of evidence to the contrary, shall be deemed to be 5 percent of the sum of the preceding factors.

Jobsite fabrication labor and its prorated share of manufacturing overhead must be included in the sale price of the machinery or equipment. Jobsite fabrication labor includes assembly labor performed prior to attachment of a component or the machinery or equipment to a structure or other real property.

(D) Cost Plus A Fee Contracts. When a contractor enters into a construction contract for a cost plus a fee or time and materials plus a fee, whether the fee is a lump sum

or a percentage of costs, the fee is not included in the measure of tax. When the contractor is the manufacturer of the fixtures or machinery and equipment, the "cost price" of the fixtures and the gross receipts from the sale of the machinery and equipment shall be determined in accordance with (B) and (C) above.

(3) MISCELLANEOUS SALES BY CONTRACTORS. In addition to sales of fixtures and machinery and equipment, tax applies to all retail sales by contractors of tangible personal property, including parts, supplies, tools, construction equipment, buildings severed or to be severed by the contractor, and furniture, including furniture sold with a building, even though the building is sold "in place."

(4) PERMITS. Contractors engaged solely in performing construction contracts which do not involve the sale and installation of fixtures and who do not also engage in business as sellers or retailers are not required to hold seller's permits. However, if a contractor is a seller or retailer because he makes sales of fixtures, materials, or machinery and equipment, or other tangible personal property either in connection with or as part of a construction contract, or otherwise, he is required to hold a seller's permit.

(5) SUPPLIES AND TOOLS FOR SELF-USE. Contractors are the consumers of supplies such as oxygen, acetylene, gasoline, acid, thread-cutting oil, and tools and parts for tools, which they use in their business, and the tax applies to the sale of such supplies and tools to contractors.

(6) EXEMPTION CERTIFICATES.

(A) Resale Certificates. Contractors holding valid seller's permits may purchase fixtures and machinery and equipment for resale by issuing resale certificates to their

suppliers. They may not purchase materials for resale unless they are also in the business of selling materials.

A contractor cannot avoid liability for sales or use tax on materials or fixtures furnished and installed by him by taking a resale certificate from the prime contractor, interior decorators, designers, department stores, or others. However, under the circumstances described in subsection (b)(2)(B)3., a contractor may take a resale certificate for fixtures furnished and installed by him for a person other than the owner of the realty.

(B) Exemption Certificates for Out-of-State Use. Sales tax does not apply to sales of tangible personal property to a construction contractor who holds a valid California seller's permit when the property is used by the contractor outside this state in his performance of a contract to improve real property and as a result of such use the property is incorporated into and becomes a part of real property located outside this state. This exemption is available only if at the time of the purchase the contractor certifies in writing to the seller that he holds a valid California seller's permit (giving the number of that permit and identifying the property purchased) and states that the property will be used in the manner stated above. The certificate must be signed by the contractor or an authorized employee. Such a certification may appear in the body of a purchase order which bears the signature of the purchaser. Any certificate given subsequent to the time of purchase will not be recognized.

If the property purchased under a certificate is used by the contractor in any other manner or for any other purpose than stated in the certificate, the contractor shall be liable for sales tax as if he were a retailer making a retail sale of the property at the time of such use, and the sale price of the property to him shall be deemed the gross receipts from the sale.

(C) Deductions for Tax-Paid Purchases Resold. A contractor may claim a "tax-paid purchases resold" deduction for any property of which he is the retailer when he has reimbursed his vendor for tax which the vendor is required to pay to the State or has paid the use tax with respect to the property, and has resold the property prior to making any use of it. In the event that the contractor sells short ends or pieces which are not used other than in severing them from larger units purchased by him and as to which he has paid sales tax reimbursement or use tax, he may claim the deduction for tax-paid purchases resold, but the amount of the deduction shall not exceed the price at which he sells such short ends or pieces.

(c) PARTICULAR APPLICATIONS.

(1) DRAPERIES AND DRAPERY HARDWARE. Persons who contract to sell and install draperies including drapery hardware, such as brackets, rods, tracks, etc., are retailers of the items which they furnish and install. Tax applies to the entire contract price exclusive of the charge for installation which charge should be separately stated. Installers who furnish drapery hardware or other tangible personal property may accept resale certificates from department stores or other sellers to furnish and install the draperies and drapery hardware.

The department stores or other sellers furnishing resale certificates are required to pay the tax to the state upon their selling price of the draperies and drapery hardware, exclusive of installation charges. The installer should segregate his installation charge in order that the department store or other seller may properly segregate its charge attributable to installation for purposes of determining its taxable gross receipts.

(2) PREFABRICATED CABINETS. A cabinet will be considered to be "prefabricated" and a "fixture" when 90

percent of the total direct cost of labor and material in fabricating and installing the cabinet is incurred prior to affixation to the realty. In determining this 90 percent, the total direct cost of all labor and materials in fabricating the cabinet to the point of installation will be compared to the total direct cost of all labor and materials in completely fabricating and installing the cabinet. If more than one cabinet is fabricated and installed under the contract, each cabinet will be considered separately in determining whether the cabinet is prefabricated.

(3) PREFABRICATED BUILDINGS. Prefabricated units such as commercial coaches, house trailers, etc., registered with the Department of Motor Vehicles or the Department of Housing and Community Development, are tangible personal property even though they may be connected to plumbing and utilities. A mobilehome which meets or is modified to meet, all applicable building codes and regulations and which is permanently affixed to realty, is an improvement to realty and is not personal property. Generally portable buildings which merely rest on redwood sills, piers or like property and are attached to realty only through plumbing and utility hookups are personal property.

Prefabricated and modular buildings, other than the type described above, affixed to the realty in a manner indicating that they are intended to remain permanently or indefinitely in place are improvements to realty for the purposes of this regulation. It is immaterial whether the buildings are erected upon or affixed to land owned by the owner of the building or are leased to the landowner or lessee of the land.

Prefabricated or modular buildings which are "factory-built housing" where permanently affixed to the realty are improvements to realty. The manufacturer of factory-built

housing who contracts to furnish and install the factory-built housing manufactured by him is the consumer of the materials used in building and installing the factory-built housing and the retailer of the fixtures. Tax applies as provided in (b) above.

(4) MOBILEHOMES INSTALLED FOR OCCUPANCY AS RESIDENCES. Operative July 1, 1980, a special measure of sales or use tax is provided for a mobilehome sold to be affixed to realty for occupancy as a residence.

A mobilehome dealer who sells a new mobilehome to a construction contractor to be affixed to land for occupancy as a residence is the "retailer-consumer" of the property and is required to pay tax for the period in which the sale was made by the dealer measured by an amount equal to 75 percent of the retailer-consumer's purchase price of the mobilehome.

A construction contractor who withdraws a new mobilehome from an inventory purchased for resale to be affixed to realty for occupancy as a residence in the performance of a construction contract is required to pay tax measured by 75 percent of the purchase price by his mobilehome vendor except where the purchase is made directly from a mobilehome manufacturer. In the absence of satisfactory evidence of the vendor's purchase price it shall be presumed that the measure of tax for the transaction is an amount equivalent to 60 percent of the sales price of the mobilehome to the construction contractor.

A mobilehome manufacturer who sells a new mobilehome directly to a construction contractor for installation to real property for occupancy as a residence is required to pay

tax measured by 75 percent of the sales price at which a similar mobilehome ready for installation would be sold by the manufacturer to a retailer-consumer in this state. A construction contractor who withdraws a new mobilehome from an inventory purchased from a manufacturer for resale must pay tax measured by 75 percent of his purchase price.

A mobilehome manufacturer who performs a construction contract by permanently affixing a new mobilehome to real property is the consumer of the material and the retailer of fixtures installed by him and the tax applies as set forth in paragraph (b) above.

Reference should also be made to the provisions of Regulation 1610 for additional interpretative rules relating to custom additions to the mobilehome prior to sale; transfers of nonvehicle items, and the application of the tax to a purchase made from an out-of-state retailer.

(5) REPAIR CONTRACTS. Contracts to repair fixtures are contracts for the sale and installation of parts when the sale price of the parts is billed separately from the repair labor. Tax applies to the sale price of the parts.

A contractor who enters into a lump sum contract to repair a fixture in place or a fixture he is required by the contract to reaffix to the realty is the consumer of the parts used.

(6) ELEVATOR INSTALLATIONS. A large number of components are included in the installation of an elevator system. Those portions constituting the cage or platform and its hoisting machinery are fixtures. The balance of the installation, if attached to a structure or other real property will generally be "materials."

Similarly, installation of escalators and moving sidewalks are in part fixtures and in part materials.

Following are examples of components constituting part of the cage platform and its hoisting machinery, and which are fixtures:

alarm bell
cab or car
car doors
car platform and sling
door hanger on cab
door openers
door operator on cab or car
door safety edge on cab
door sills on cab
electronic door protector
jack assembly
motors
power units and control boxes
pumps
pushbuttons on cab
wire and piping (which are components of a fixture)

Following are examples of components constituting "materials" when attached to realty:

car guides
casing section of jack assembly
guide rails
hoistway doors
hoistway door frames
hoistway door safety edge
hoistway door sills and jams
hoistway door supports
hoistway entrance
pushbuttons on hoistway
rail brackets
sill, struts
sound insulating panels on "materials"
structural steel (unless part of cab, car, or other "fixture")
valve strainer
wire and piping attached to "materials"

Following are examples of components constituting parts of escalators or moving sidewalks which are fixtures:

staircase
moving sidewalk
moving handrails
chains
sprockets
motors
other operating mechanisms

(7) DEEP-WELL AGRICULTURAL PUMPS. A deep-well agricultural pump is tangible personal property if installed so that it rests in position by force of gravity and is not otherwise affixed to the land.

The pump is a fixture if:

(A) It is affixed to the land such as by concrete, bolts or screws,

(B) It is physically connected to an irrigation system such as by pipes or couplings so as to become an integral part of the system, or

(C) It is enclosed by a pump house or other building or structure.

(8) REMOTE CONTROL GARAGE DOOR OPENERS. Remote control garage door opening units are fixtures. Portable transmitter units furnished pursuant to a construction contract are deemed to be fixtures and are taxable as provided in subdivision (b)(2)(B). Sales of portable transmitter units not a part of a construction contract, as, for example, sales of replacement units, are retail sales of tangible personal property and subject to tax as such.

(9) EXCESS REIMBURSEMENT. The excess tax reimbursement provisions of Regulation 1700 apply to construction contractors.

Appendix A The following is a list of typical items regarded as materials:

Asphalt
Bricks
Builders' hardware
Caulking Material
Cement
Conduit
Doors
Ducts
Electric wiring and connections
Flooring
Glass
Gravel
Insulation
Lath
Lead
Lime
Linoleum
Lumber
Macadam
Millwork
Mortar
Oil
Paint
Paper
Piping, valves, and pipe fittings
Plaster
Power poles, towers, and lines
Putty
Reinforcing mesh
Roofing
Sand
Sheetmetal
Steel
Stone
Stucco
Tile
Wall coping
Wallboard
Wallpaper
Wall-to-wall carpeting (when affixed to the floor)
Weather stripping
Windows
Window screens
Wire netting and screen
Wood preserver

Appendix B The following is a list of typical items regarded as fixtures:

Air conditioning units
Awnings
Burglar alarm and fire alarm fixtures
Cabinets, counters, and lockers (prefabricated)
Electric generators (affixed to and accessory to a building, structure or fixed works)
Elevators, hoists, and conveying units
Furnaces, boilers and heating units
Lighting fixtures
Plumbing fixtures
Refrigeration units
Signs
Telephone switchboards and instruments
Television antennas
Transformers and switchgear
Vault doors and equipment
Venetian blinds

Appendix C The following are lists of typical items regarded as:

Machinery and Equipment
Drill presses
Electric generators (unaffixed, or, if affixed, which meet the requirements of subparagraph (a)(6)
Lathes
Machine tools
Moving parts of cranes
Printing presses

Not Machinery or Equipment
Fixtures and materials as defined in this regulation
Wiring, piping, etc., used as a source of power, water, etc., for machinery and equipment
Radio transmission antennas
Large tanks (i.e., over 500 barrel capacity)
Fire alarm systems
Street light standards
Cooling towers other than small prefabricated cooling units

History: Effective July 1, 1939.

Adopted as of January 1, 1945, as a restatement of previous rulings.

Amended September 2, 1965, applicable as amended September 17, 1965.

Amended and renumbered November 3, 1971, effective December 3, 1971.

Amended February 4, 1976, effective April 1, 1976. Rewrote and expanded regulation for clarity, combined Regulation 1615, added particular applications, and applied Regulation 1521 definition of "fixture" to U.S. Contractors.

Amended August 17, 1976, effective September 19, 1976. Clarified "U.S. Government," limited exemption certificate, and clarified "generators" in appendices.

Amended December 7, 1978, effective February 18, 1979. Subsections (a)(3), (b)(1)(A), and (b)(1)(B) no longer reference instrumentalities of the United States; subsection (b)(1)(A) was amended to apply sales tax to the sale of tangible personal property to contractors for use on construction contracts with the United States; amends subsection (c)(7) to provide that the section only applies to transactions prior to 1/1/79.

Amended August 1, 1980, effective August 22, 1980, operative July 1, 1980. On first page, added (c)(4) and renumbered following subsections; in (c)(3), first sentence, deleted "mobile homes" and substituted "commercial coaches"; in third paragraph, deleted "as defined in Regulation 1521.2," from first sentence, and deleted second sentence; added (c)(4), and renumbered following sections.

Amended November 19, 1980, effective January 16, 1981. In (c)(3) corrected typographical error. In (c)(4), third paragraph, substituted "construction contractor"

for "any person,"; added "in the performance of a construction contract," and added exception for purchases made directly from a mobilehome manufacturer; substituted "construction contractor" for "person withdrawing and affixing the property to realty,". In fourth paragraph, added provision re withdrawal by construction contractor of new mobilehome from inventory purchased from a manufacturer.

Amended December 1, 1983, effective April 14, 1984. In (c)(3) added reference to the Department of Housing and Community Development. In (c) added new (c)(8) and renumbered former (c)(8) to (c)(9); deleted former text and added reference to Regulation 1700. Deleted former subdivision (d). In appendix C changed reference to subparagraph (a)(6).

Appendix B

DEFENSE PROCUREMENT CIRCULAR

15 June 1977 NUMBER 76-8

This Defense Procurement Circular is issued by direction of the Secretary of Defense pursuant to the authority contained in 5 U.S. Code 301, 10 U.S. Code 2202, DoD Directive No. 5126.22, and ASPR 1-106.

All Armed Services Procurement Regulation material and other directive material published herein is effective upon receipt except as otherwise indicated.

Unless otherwise indicated in the introductory language preceding an item, each item in this Circular shall remain in effect until the effective date of that subsequent ASPR revision which incorporates the item, or until specifically canceled.

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SPECIAL NOTE: All replacement pages furnished with Defense Procurement Circulars *(whether or not identified by specific items)* are replacement pages for the 1976 Edition of ASPR.

ITEM X—GUIDANCE—STATE AND LOCAL SALES AND USE TAXES

The Office of Federal Procurement Policy recently expressed concern with assertions by the Department of Defense (DoD) and its contractors of immunity under the United States Constitution from state and local sales and use taxes on the basis that the contractors are agents of the United States in purchasing supplies for use in performance of their DoD contracts.

The DoD policy on this matter was first set forth in a 1955 letter to the Director of the Bureau of the Budget as follows: "It has been determined that it will be the policy of the Department of Defense not to designate prime contractors on cost-type contracts to be performed within the continental limits of the United States, as agents of the Government for the purchase of supplies." This policy was adopted shortly after the decision of the United States Supreme Court (*Kern-Limerick, Inc. v. Scurlock* 347 U.S. 110 (1954)) which was favorable to the United States and its contractor because the contract involved contained a clause which appeared to have as its purpose the avoidance of a state tax. The policy was adopted to preclude the inclusion in DoD contracts of clauses which were designed to avoid otherwise validly imposed state or local taxes. That policy is still in effect today.

While DoD policy not to include clauses in DoD contracts designating contractors as agents of the Government is clear, the question arises whether it is appropriate, in the absence of a contract clause expressly designating a contractor as an agent of the Government, for the Government to contend in a dispute with a state taxing authority that the contractor is in fact an agent of the Government for

the purpose of immunity from state and local sales and use taxes. In this regard, the Office of Federal Procurement Policy has advised that:

> ". . . existing legal precedents lend little support for the contention that a contractor is an agent on the basis of Government title and subcontract-review clauses or other arrangements short of contract provisions clearly intended to make the contractor an agent of the Government or authorizing him to pledge the credit of the Government or make purchases in its name or for its account."

While DoD has agreed in general with this expression of legal precedents, there could be circumstances where it could be properly contended that the contractor is an agent of the Government for the purpose of immunity from a state and local sales and use taxes. Circumstances giving rise to such a situation would seemingly be rare. It is DoD intention to ensure that procurement activities do not contend that contractors are agents of the Government where circumstances surrounding the procurement do not clearly support the contention.

Before any DoD activity contends that any of its contractors are agents of the Government for the purpose of claiming immunity from state or local sales or use taxes, the matter will be referred to the Office of the Secretary of Defense (OSD), Assistant Secretary of Defense (MRA&L) for review to ensure that they are in conformance with DoD policies and the contention is fully in accord with the pertinent legal principles and precedents. Each case forwarded will be reviewed at the Secretarial level in the Military Departments and the Director level in the Defense agencies before referral to OSD. The referral will include all pertinent data on which such a contention would be based, together with a thorough analysis of all relevant legal precedents.

Whenever clauses, procedures and business practices are cited by DoD activities to support the contention that a contractor is an agent of the Government for the purpose of immunity from a state or local sales or use tax, it is our intention whenever possible to devise alternative clauses, procedures and practices for future use which will accomplish their intended purpose without providing the basis for the contention that the contractor is an agent of the Government for the purpose of immunity from state or local sales or use taxes. Therefore, any referral to OSD will include comment on the extent to which alternate clauses, procedures or practices may be utilized to accomplish the intended purpose without providing the basis for the contention that the contractor is an agent of the Government for the purpose of immunity from state and local sales and use taxes.

There are, and will remain, bases for challenging the application of state taxes to transactions by DoD contractors which do not depend upon the contention that the contractor is immune on constitutional grounds because of the existence of an agency relationship between the Government and the contractor. Claims for exemption from state or local sales or use taxes, which are not based on that contention will not be submitted to OSD for review.